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C O N F I D E N T I A L SECTION 01 OF 08 SHANGHAI 006957

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DEPT FOR EAP/CM, INR/B AND INR/EAP
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SUBJECT: PENSION SCANDAL CLAIMS MORE; POLITICS AS USUAL

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CLASSIFIED BY: Kenneth Jarrett, Consul General, U.S. Consulate,
Shanghai.

REASON: 1.4 (b), (d)

(U) Classified by Pol/Econ Chief Mary Tarnowka for reasons 1.4
(b) and (d).

¶1. (C) Summary: The Shanghai pension scandal, to date, has snared some 50 business and political leaders, with the number continuing to rise. Four of our well-placed contacts recently took the view that the current investigation was not primarily designed to clean up Shanghai--although that was a side benefit. Rather, the campaign was intended to allow President Hu Jintao to consolidate his authority. These contacts expected Executive Vice Premier and Politburo Standing Committee Member Huang Ju and acting Shanghai Party Secretary Han Zheng to escape relatively unscathed, with Huang to retire at the 2007 Party Congress and Han to move on to another, likely lateral position. Our contacts expressed hope that a Hu Jintao protege would backfill for Han, providing crucial access to top decision makers. Meanwhile, they expected that Shanghai officials would be less willing to take risks and that Shanghai generally would assume a somewhat lower profile. End summary.

¶2. (C) Poloff met with Tongji University Professor and Shanghai Chinese People's Political Consultative Conference (CPPCC) member Frank Peng on October 20 and with Shanghai Municipal People's Congress (MPC) Researcher Zhou Meiyun on October 25 to discuss the fallout of the pension scandal that toppled Shanghai Party Secretary Chen Liangyu. Separately, Pol/Econ Chief and Econoff met on October 24 with JP Morgan China VP Andrew Zhang who offered additional insights on the case, as did Carlyle Group Shanghai Chief Representative Luo Yi in a meeting with Pol/Econ Chief on October 27. Additional material has been summarized from other discussions and local, Hong Kong and international press.

13. (C) According to press reports, as of October 23, 50 people were currently under investigation for possible involvement in the Shanghai social security scandal that toppled Shanghai Party Secretary and Politburo Member Chen Liangyu. The list (at para

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17 below) reveals a veritable "Who's Who" of Shanghai's top political and business leaders and shows the scope of how deeply the central government is reaching to root out corrupt and/or recalcitrant leaders.

Just an Old-Fashioned Bare Knuckle Political Brawl

14. (C) Shanghai MPC Researcher Zhou Meiyan said that the current pension scandal investigation had little to do with a desire to truly clean up the party and much more to do with President Hu doing away with his political opponents. Andrew Zhang added that Hu's attack against Chen was based on political calculations of rivalry, with the underlying convenience of a corruption investigation. Zhou averred that Hu was not really acting out of concern for the national interest, but was more concerned with protecting his position, allowing that consideration to govern his decision making. In this sense, Zhou said, Hu was no different in his political ambitions than former President Jiang Zemin. Zhou likened Hu's removal of Chen Liangyu to Jiang's removal of Chen Xitong from office and said the only difference was that Hu was able to provide better window dressing than Jiang for carrying out his personal vendetta in the form of an anti-corruption campaign.

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Extent and Benefits of Corruption

15. (C) Zhou and Andrew Zhang assessed that Chen was not guilty of any large-scale malfeasance that would actually warrant his removal. Zhang said from what he had heard, Chen had only benefited by getting two small apartments in Shanghai and his son receiving some compensation for facilitating business relations, services which he claimed would have been considered legitimate in other countries. Zhou believed that Chen's personal corruption was low by Chinese officialdom standards. The biggest mistake Chen made--and the technical reason he had been removed--was that he had violated a central regulation forbidding investing pension funds in private companies. Luo, however, said Chen was definitely corrupt, and noted he had mistresses and a son out of wedlock. However, he said the corruption was also what made him effective and was the lubricant that kept things running smoothly in Shanghai. Luo said that for Chinese businessmen, corrupt officials were better than most of the regular bureaucrats since they were willing to make decisions and take risks -- for a price. He said Shanghai could appear clean to foreigners -- as it did to Carlyle -- since it was keeping the wheels greased off deals with local businesspeople. (Comment: Zhou and Zhang's apparent sympathy for Chen is not a mainstream view. There is little indication that ordinary Shanghainese feel remorse over Chen's downfall. And we have seldom heard criticism of the action even from members of the Shanghai elite who would understand that Chen's principal sin was probably political, not economic. End Comment.)

16. (C) According to Zhou, although Chen's family and subordinates apparently prospered from the arrangement with Fuxi Investment Holdings, the pension fund investments actually made excellent returns. In fact, Shanghai was able to promise its retirees a higher rate of return than other provinces. While rich coastal provinces approved of Chen's methods, hoping to implement similar programs, poorer, inland provinces began complaining to the central government that Beijing should give them subsidies to allow them to offer better pension returns to their residents as well. In turn, Hu and Wen accused Chen of creating disturbances and undermining the construction of a "Harmonious Society."

Character and Honor at Stake

17. (C) Zhou said all of this pointed to the fact that Hu was using this "scandal" as a pretext to remove Chen, who was a political thorn in his side. Frank Peng said that Chen had been singled out for investigation for at least two reasons. First, Chen was part of former President Jiang Zemin's network and served as a high-profile target to establish President Hu Jintao's dominance of the political system. Peng said he had heard that Jiang's son, Jiang Mianheng, had been implicated in the pension scandal and that the information the investigation had turned up had been used to help persuade Jiang to criticize Chen. Andrew Zhang said that Jiang had "traded" Chen Liangyu to protect a family member-- a nephew of his wife --who was facing political problems. Zhang also said Chen's ouster effectively demonstrated that Hu had managed to marginalize Jiang, who only retained a limited senior advisor role.

18. (C) Luo said he had heard that what originally got Chen in trouble was trying to interfere with the Zhou Zhengyi real estate scandal investigation by calling for a meeting with the

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chief investigator and saying that the case should be handled in Shanghai. The investigators left Shanghai but reported to Beijing that the only reason Chen Liangyu would be so concerned was because he personally had something to hide. This resulted in initiation of an investigation of Chen. When Chen stood up publicly to Hu Jintao and Wen Jiabao resisting macroeconomic controls in 2004, the investigation intensified. Luo said according to several of "the kids" (sons and daughters of senior party leaders with whom he associates in Beijing), the need to do something about Chen now became critical because otherwise he would have been on track for promotion to the Standing Committee next Spring. According to an internal book on Chen's offenses that Luo had heard about, two of the worst involved disparaging the character and honor of President Hu. Apparently, Chen had ridiculed a photo taken of Hu in Tibet wearing a helmet to deal with protestors, saying that Hu wasn't anywhere near the front line and if he still needed a helmet, he wasn't fit to govern the country. In another instance, Chen had criticized Hu for not visiting his mother's grave himself, but rather sending his son as a proxy. Luo said it would have been unbearable for Hu to have had Chen in the Standing Committee when he was saying things like this behind his back.

19. (C) Frank Peng commented that the real reason for Chen's demise was arrogance. Chen continued to infuriate both Hu and Wen with his recalcitrant attitude and refusal to fall in line with central policy. Peng noted, for instance, that Chen had

refused Wen Jiabao's directive that Shanghai pony up more of its tax revenue to Beijing to support the 2008 Olympics on the grounds that Shanghai was itself preparing for the 2007 Special Olympics and the 2010 World Expo. Chen had (mistakenly) believed himself untouchable due to his relationship with Jiang and thus believed he was able to challenge on policy issues, according to Zhou.

¶10. (C) Further demonstrating the political nature of the current investigation, Peng pointed out that Statistics Bureau Commissioner Qiu Xiaohua had gotten on Premier Wen's bad side. Qiu had fallen out with Wen over the Premier's calls to rein in the economy through macro controls. Although he hesitated to say that Wen had removed him solely because of political grievances, Peng noted that Qiu's replacement, Xie Fuzhan, the former Deputy Director of the State Council Development Research Center (DRC), was seen as close to Wen, as was the DRC Director.

How High Will it Go?

¶11. (C) Our contacts for this message offered no predictions on when the current investigation would end. They did not believe there would be another Politburo-level victim. Frank Peng said that Hu had little reason to move the investigations upwards since there were no high-level leaders left who opposed him.

¶12. (C) According to Peng, Politburo Standing Committee Member Huang Ju was "definitely tied" to the pension scandal and Hu and Wen were currently deliberating how to handle the issue. Peng assessed that Huang would stay on in his current positions until the 2007 Party Congress when he would definitely retire. (Note: Peng again insisted that Huang did not have pancreatic cancer but had already recovered from a pancreatic infection. End note.). Zhou Meiyang said that Hu and Huang had reached an "agreement" that Huang himself would not be touched (although his wife was apparently not part of the bargain), and in return, Huang would not offer any resistance to Hu's attack on Chen or to Hu's policy agenda.

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¶13. (C) Zhou also said it was unlikely that acting Shanghai Party Secretary Han Zheng would be sacked over the scandal. Han, Zhou assessed, had successfully been able to distance himself from Chen, as evidenced by official press reports lauding Han as a "good cadre" whom the central leadership had faith in. Zhou said that Han had been implicated in the investigation, with Zhang adding that he also had a mistress, but had kept his job by "shooting Chen Liangyu in the back." Han would be allowed to keep his job as essentially a caretaker until the 2007 Party Congress or 2008 People's Congress, and would then retire or be "promoted" into an unimportant job somewhere else, according to Zhang. Luo said Han was also corrupt, although perhaps not to the same degree as Chen, and was not likely to be kept around for long.

¶14. (C) Luo said the scandal had everyone nervous. He said he was having breakfast with several of "the kids" the morning that Chen Liangyu's removal was announced -- just before the official announcement was made. Luo said the scandal investigation was the elephant in the room that no one talks about. He said all the kids "on both sides" were keeping their noses clean, staying

out of trouble and avoiding business deals.

Blow to Shanghai's Image

¶15. (C) Andrew Zhang concurred with some other Consulate contacts, including Shanghai MPC Legal Affairs Commission Director Shen Guoming (Ref B), in stating that the recent scandal did not mean that Shanghai was more corrupt than other areas of China; he believed it was relatively cleaner. Zhang said "real" anti-corruption investigations were going on elsewhere in China; this one was political. Frank Peng was optimistic that the overall impact of this investigation would be to leave Shanghai a cleaner city than others in China in the long-run, and a better place to invest. Peng said that because Shanghai was still a central part of the national development strategy, it would probably retain its Politburo seat. He said that either Organization Department Director He Guoqiang or Liaoning Party Secretary Li Keqiang (both Hu protigis according to Peng) was likely to take over the Party Secretary position in Shanghai along with the Politburo slot. Zhang and Luo, however, believed that the scandal would have damaging consequences for Shanghai. As long as Han was Party Secretary, there would be no real advocate for Shanghai's interests and Shanghai officials would be reluctant to take risks. When Han was finally replaced--even if it was with a successor hand-picked by Hu--it would take time for the successor to get up to speed and have a new team in place. Our contacts expected Shanghai to assume a somewhat lower profile at least in the near-term.

Additional Local Leadership Changes Underway

¶16. (SBU) PRC-connected Hong Kong press first reported several personnel changes underway, later confirmed by Mainland press, and not necessarily related to the pension scandal. On October 26, Hong Kong-based Ta Kung Pao reported that Jiang Sixian, Chief of the Shanghai Organization Department, Shanghai State-Owned Assets Supervision and Administration Commission (SASAC) Party Secretary, and a Shanghai Standing Committee Member (and tennis partner of Chen in July, ref F) was transferred to Hainan as a vice governor, although he was not named to the Hainan Provincial Standing Committee. The article

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speculated that given the involvement of two of Jiang's subordinates in the pension scandal, Jiang's reputation was tainted and he would likely remain under investigation. The article predicted that Jiang would be replaced by Shanghai CPC United Front Director Shen Hongguang, and that if Shen was promoted, Vice Mayor Yang Xiaodu, who had worked in Tibet from 1977 to 2001, would likely take his place. (Note: Shen's resume would have put him in Tibet when Hu Jintao was serving there in the late 1980s. End note.) The article also said that if Shen moved up, Shanghai Government Secretary General Ms. Yang Dinghua would be the likely candidate to replace him. As of October 27, Jiang was not listed on the Hainan Provincial Government's website, www.hainan.gov.cn, but he was also no longer listed on the Shanghai Organizational website (www.shjcdj.org.cn). An October 26 Sina report confirmed that Shen replaced Jiang as Organizational Department Chief. October 27 Xinhua and news.21cn.com reports confirmed that Yang Dinghua replaced Yang Xiaodu as Vice Mayor, and that Yang Xiaodu had been appointed United Front Work Department Director, succeeding Shen.

Programs! Can't Tell the Players Without a Program

¶17. (C) Chen Liangyu, detained on September 24 after being called back to Beijing. Chen's case is currently under investigation by the Central Discipline Inspection Commission (CDIC). According to Andrew Zhang, Chen has a mistress in Beijing who works for the Ministry of Finance who, as of yet, has remained untouched by the investigation.

- Zhang Rongkun, Chairman of Fuxi Investment Holdings and a CPPCC member, was placed under investigation July 24, removed from the CPPCC on October 16, and arrested on October 21, according to Sina and Radio Free Asia. According to Hong Kong-based Oriental Daily, during his investigation, Zhang is said to have provided a name list of 20 officials he bribed, as well as a cache of sexually explicit and compromising videos he had taken of many of these officials.

- Wu Minglie, President of the New Huangpu Group, a real estate development company, and Shanghai MPC delegate. According to Oriental Daily, the CDIC launched an investigation into Wu on September 2 for embezzlement of the government's "extra-budgetary funds," including social security funds. He was removed from his MPC seat on September 29, according to press reports. Hew Huangpu was founded in 1994 by Chen Liangyu and is involved in a number of construction projects related to Shanghai's hosting of the World Expo in 2010. According to Frank Peng, Wu was nicknamed "Chen Liangyu's Wallet." He said that Wu paid 1.56 million RMB in "traveling fees" to subsidize Chen's wife and son on a recent visit to the United States. Wu also provided a 149 square meter home to Chen's father in 1998.

- Zhu Junyi, Shanghai Bureau of Labor and Social Security Director and Shanghai delegate to the National People's Congress (NPC). According to People's Daily, Zhu was removed from his Shanghai position on August 9 for suspicion of bribery and misuse of pension funds; his NPC duties were terminated on August 11. Zhu reportedly loaned between 3-7 billion RMB from Shanghai's pension funds to Fuxi Investment, which used the funds in part to build the Shanghai-Hangzhou Expressway. According to Zhou Meiyan, although Zhu made significant returns on the investments, all of which went back into pension payments, he was in violation of central government regulations forbidding the investment of pension funds into private

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companies. In an October 18 conversation with the Consul General, National Council for Social Security Fund Vice Chairman Gao Xiqing said that Shanghai's use of pension funds in this manner violated central government regulations, but acknowledged that the regulations were imprecise and generally unenforced. Zhu was also the subject of at least one of Zhang's videos, according to Hong Kong Oriental Daily press reports.

- Qin Yu, District Mayor of Shanghai's Baoshan District and Chen Liangu's former secretary (mishu). Xinhua reported on August 24 that Qin had been found to have seriously violated disciplinary regulations and was thus under investigation. Qin was another of the subjects of at least one of Zhang's compromising videos, according to Hong Kong Oriental Daily press reports. He was also the recipient of generous bribes Zhang paid to gain access

to Chen, according to Zhou Meiyun. Zhou said Qin had received enough money to purchase five homes throughout Shanghai.

- Yu Huiwen, wife of Huang Ju and Vice President of the Shanghai Charity Foundation. Yu had been detained and is under "Double Designation" (shuang gui) restrictions (ie, she must attend questioning sessions at a designated place and for a designated duration) pending completion of the investigation against her, according to Zhou Meiyun. According to Hong Kong Ming Pao, the Shanghai Charity Foundation has acted as a facilitating body, allowing wealthy businesspeople who make donations the opportunity to meet Yu and influential leaders in her husband's circle. Zhang Rongkun was also an honorary vice president of the Foundation.

- Huang Xi, Vice President of the Pudong Development Group and Huang Ju's younger brother. According to Hong Kong Ming Pao, Huang is being investigated by the CDIC for his ties to Zhang Rongkun.

- Chen Liangjun, Chen's younger brother. A businessman, Chen Liangjun reportedly received favorable business deals from Zhang Rongkun as a result of his brother's cooperation on pension fund investments into Fuxi Investment. Chen had been detained and was currently subject to the shuang gui restrictions, according to Zhou Meiyun.

- Qiu Xiaohua, Commissioner (aka Director) of the National Bureau of Statistics and CPPCC member, was removed from his position on October 19 after it was revealed that he was being investigated for his possible role in the pension scandal, according to Xinhua. Qiu had only held the position since March. Although Qiu had never served in Shanghai, press reports claim that Qiu met Zhang Rongkun through the CPPCC. According to Boxun News, Zhang reportedly took an interest in Qiu because of his access to senior leaders and brought Qiu to Shanghai for a "vacation" where Zhang introduced him to a woman who reportedly became Qiu's mistress. Neither Zhou Meiyun nor Frank Peng knew of any direct tie to the pension scandal.

- Wang Chengming, Chairman and Party Secretary of the Shanghai Electric Group and member of the Municipal People's Congress (MPC). Wang was placed under investigation by the CDIC on August 13, according to Xinhua. He was removed from his MPC post on September 28.

- Han Guozhang, Vice President of Shanghai Electric Group. According to China Securities and Beijing-based The Economic Observer, the CDIC began investigating Han on August 2 and took

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him to Nanjing for questioning. Sina and Xinhua report Han was suspected of accepting bribes and embezzling money from a company-financed retirement fund for former employees. That fund was managed by the Municipal Labor and Social Security Bureau and is believed to be related to the sacking of Zhu Junyi.

- Xu Wei, Chairman of Shanghai Electric Group's Board of Directors, and Shanghai Electric Group's Deputy Director of the Investment Management Department was placed under "double designation" restrictions, according to an October 19 Xinhua report. Andrew Zhang noted that China's power grid was "owned"

by former NPC Chairman Li Peng's family members.

- Sun Luyi, Shanghai Deputy Party Secretary and General Office Director. On September 28, Sun was "asked to assist" in the pension scandal investigations, a euphemism for being placed under investigation, according to Xinhua. According to an October 3 article from the 21st Business Herald, Sun was suspected of accepting bribes from Zhang Rongkun, and was one of the 20 people on Zhang's list of bribed officials.

- Han Fanghe, General Manager of the Hua An Fund Management Company, Ltd. The October 13 Economic Observer said that Han was under investigation for "serious violation of disciplinary regulations." Although not much is available about Han's case, it is rumored that he used the pension funds to complete the management buy-out of Hua An. Hua An is owned in part by an arm of Fuxi Investment and the Shanghai Electric Group.

- Yu Zhifei, General Manager of the Shanghai International Circuit and "China's Godfather of Formula One Racing." According to Shanghai-based Oriental Morning Post, Yu was detained by the CDIC on October 14. Although details of the case remain sketchy, Yu supposedly became close to Chen Liangyu while serving together in Shanghai's Huangpu District Government.

- Ling Baoheng, Director of the Shanghai SASAC, and his deputy, Wu Hongmei. Shanghai official press Eastday.com reported on October 24 that both Ling and Wu were "assisting in the investigation" of the pension scandal.

- Zhou Yupeng, Shanghai Vice Mayor. According to Hong Kong Ping Kuo Jih Pao, Zhou is under investigation for his role in approving the 3 billion RMB in loans made by Zhu Junyi to Zhang Rongkun.

- Yu Guoxiang, Chairman of the Board of the Ningbo Xinhengde Real Estate Company, Ltd. According to Hong-Kong based Sing Tao and Xinhua, Yu was close to Chen Liangyu and had used Shanghai pension funds to purchase 90 percent of the shares in the Shanghai Ling-an Hilton International Hotel. The investment was worth USD 150 million.

- Wu Zhiming, Director of the Shanghai Public Security Bureau, and Xin Jude, Director of the Shanghai People's Armed Police were implicated in the scandal and were reportedly removed from their posts just prior to Chen Liangyu's ouster (Ref A). However, both Wu and Vice Mayor Zhou Yupeng were reported by Tokyo press Tokyo Shimbun to have attended National Day celebrations on September 30.

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- Xu Jianguo, Director of the Shanghai Economic Commission, Shanghai No. 1 Intermediate Court Chief Judge Bao Xianming, and Shanghai Maritime Court Deputy Director Shen Mantang were fired from their positions due to involvement in the scandal, according to a Xinhua report.

Cases to Watch

¶18. (SBU) Although there have been no direct links drawn to the pension scandal, Xinhua reported on October 25 that two China Eastern Airlines deputy general managers, Wu Jiuhong and Tong Guozhao, were being investigated by the CDIC and SASAC. In addition, five people, including General Manager of China Eastern's Freight Transport Department Xiao Qixian and Deputy General Manager of Air Cargo Wang Qiang, were detained by the Shanghai Changning District Procuratorate for possible bribe-taking in August. Xiao's subordinate, Wu Sheng--Wu Jiuhong's former secretary--was also called in for questioning. Also, in July, the CDIC launched an investigation into Wang Wulong, a vice chairman of the Jiangsu People's Congress, although no details of the case have been disclosed, according to press reports.

JARRETT